IN THE

Supreme Court of the United States

OCTOBER TERM, 1971

No. 70-5

NELLIE SWARB, ET AL., *Appellants*,

v.

WILLIAM M. LENNOX, ET AL., *Appellees*.

On Appeal From the United States District Court for the Eastern District of Pennsylvania

---

BRIEF FOR THE AMERICAN BANKERS ASSOCIATION APPEARING AS AMICUS CURIAE

MATTHEW HALE
General Counsel
The American Bankers Association
1120 Connecticut Avenue, N.W.
Washington, D. C. 20036

November 3, 1971

Press of Byron S. Adams Printing, Inc., Washington, D. C.

TABLE OF CONTENTS

	Page
Interest of Amicus Curiae	1
Summary of Argument	3
Background Information	5
Consumer Credit	5
Growth and Importance	6
Credit Factors and Consumer Loans	17
The Consumer Loan Contract	21
The Loss Experience	22
Pricing Consumer Credit	27
Studies of Effects of Changes in Costs and Changes in Creditors' Remedies	31
The Home Mortgage Industry	33
Current Legislation	35
National Commission on Consumer Finance	37
Argument	
I. The waiver of notice permitted under the Pennsylvania confession of judgment procedure satisfies the constitutional due process requirements when entered into "intentionally, understandingly, and voluntarily"	39
II. Any ruling in this case which invalidates the Pennsylvania confession of judgment procedure or establishes procedures related thereto should be given only prospective effect and should not apply retroactively	40
III. No substantial evidence was introduced indicating any need for the establishment of a procedure in cases involving real estate mortgages to determine whether confession of judgment clauses in such mortgages were entered into "intentionally, understandingly, and voluntarily"	41

Page

IV. This Court's stay prohibiting execution under any judgment based on an instrument containing a confession of judgment clause, even though the procedure was not used, was unreasonable and should be terminated 42

V. Any decision reached by this Court should be restricted to the specific situation before the Court and should not undertake to review and pass upon confession of judgment procedures under California statutes or elsewhere on a nationwide basis 43

Conclusion 45

APPENDIX A: National Commission on Consumer Finance Outline of Research Program and Report on Current Study Projects 46

INDEX OF CITATIONS

CASES:

American Surety Co. v. *Baldwin*, 287 U.S. 156 (1932) 39
Armstrong v. *Manzo*, 380 U.S. 545 (1965) 40
Barnes v. *Hilton*, 118 Cal. App. 2d 108, 257 P. 2d 98 (1953) 44
Boddie v. *Connecticut*, 401 U.S. 371 (1971) 39
Cipriano v. *City of Houma*, 395 U.S. 701 (1969) 40
Johnson v. *State of New Jersey*, 384 U.S. 719 (1966) .. 40
Osmond v. *Spence*, U.S. Supreme Court, October Term, 1971, No. 70-291 44
Overmyer v. *Frick*, U. S. Supreme Court, October Term, 1971, No. 69-5 44
Sniadach v. *Family Finance Corporation*, 395 U.S. 337 (1969) 40
Swarb v. *Lennox*, 314 F. Supp. 1091, 1112 (E.D. Pa. 1970) 4, 43, 45

CONSTITUTION:

U. S. Constitution, Amendment XIV 39

Page

STATUTES:

Calif. Code of Civil Procedure § 1133 (Deering) 44

Commerce Clearing House, Consumer Credit Guide, Para. 610, Judgment Notes, Vol. 1, pgs. 2301-2311 44

Consumer Credit Protection Act (Titles I-V) (P.L. 90-321, 82 Stat. 146, 15 U.S.C. 1601) 2, 33, 36, 37, 38

Title VI, Fair Credit Reporting Act, added by § 503 of P.L. 91-508, 84 Stat. 1127, 15 U.S.C. 1681 36

Unsolicited Credit Cards, §§ 501, 502 of P.L. 91-508, 84 Stat. 1126, 15 U.S.C. 1642-44 36

Extension of the Reporting Date for the National Commission on Consumer Finance (P.L. 91-344, approved July 20, 1970) 37

National Bank Act, 12 U.S.C. ~~24~~ 38 35

Uniform Consumer Credit Code, National Conference of Commissioners on Uniform State Laws; approved by the American Bar Association, August 7, 1968 35

Colorado Rev. Stat. § 73-1-101 (1971) 36

Idaho Laws 1971, Ch. 299 (Effective July 1, 1971) 36

Indiana Code of 1971 § 19-21-101 (1971) 36

Oklahoma Laws 1969, Title 14A, § 1-101 (1969) 36

Utah Code Annotated, Ch. 9 (1953) 36

Wyoming Code Annotated § 40-1-101 to 40-9-103 (1971) 36

BILLS:

Fair Credit Billing Act, S. 652, 91st Congress (1971) .. 36

REGULATIONS:

Board of Governors, Federal Reserve System, Regulation W. (1941) 8

Page

MISCELLANEOUS:

The American Bankers Association, *Instalment Credit*, 1964 .... 6, 7

David Durand, *Risk Elements in Consumer Instalment Financing* (Princeton, N.J.: Princeton University Press, 1941) 18

Paul McCracken, *Consumer Instalment Credit and Public Policy* (Univ. of Michigan, Ann Arbor, Michigan, 1965) 6, 19

Geoffrey H. Moore and Philip A. Klein, *The Quality of Consumer Instalment Credit* (New York: National Bureau of Economic Research, 1967) .. 19, 20, 24

Roland I. Robinson, *The Management of Bank Funds* (New York, 1962) 12

Robert P. Shay, "Major Developments in the Market for Consumer Credit Since the End of World War II," *Journal of Finance*, May, 1966 .... 6, 8

Paul F. Smith, *Consumer Credit Costs, 1949-59*, A Study of the National Bureau of Economic Research (Princeton, N. J.: Princeton University Press, 1964) 12, 26, 27

Paul F. Smith, "Measuring Risk on Instalment Credit," *Management Science*, November, 1964 19

U.S. Board of Governors, Federal Reserve System *Consumer Instalment Credit* (Washington, D. C.: Govt. Print. Office, 1957) 6

University of Washington, *The Impact of a Consumer Credit Interest Limitation Law — Washington State: Initiative 245* (Seattle, 1970) 32, 33

Page

LIST OF TABLES

Table	1	Total Instalment Credit, 1939-70	10
Table	2	Consumer Instalment Credit by Source of Funds, 1939-70	11
Table	3	Consumer Instalment Credit Held by Commercial Banks	13
Table	4	Loans to Individuals Held by Insured Commercial Banks, 1945-70	14
Table	5	Consumer-Instalment Credit Outstanding and Disposable Personal Income, 1939-70 ..	16
Table	6	Total Liabilities of Households, 1945-70 ..	17
Table	7	Percent of Consumer Instalment Loans at Commercial Banks Delinquent 30 Days and Over	24
Table	8	Losses on Consumer Credit by Lender, 1959	26
Table	9	Costs of Instalment Loan Function in Commercial Banks, 1970	29
Table	10	Mortgage Loans Outstanding on One- to Four-Family Nonfarm Homes, by Type of Lender	34

IN THE

Supreme Court of the United States

OCTOBER TERM, 1971

No. 70-6

NELLIE SWARB, ET AL., *Appellants*,

v.

WILLIAM M. LENNOX, ET AL., *Appellees*.

On Appeal From the United States District Court for the Eastern District of Pennsylvania

---

BRIEF FOR THE AMERICAN BANKERS ASSOCIATION APPEARING AS AMICUS CURIAE

INTEREST OF AMICUS CURIAE THE AMERICAN BANKERS ASSOCIATION

The American Bankers Association (the A.B.A.) which files this brief with the leave of this Court[1] is a trade association having as members more than 13,000 commercial banks, large and small, located in every state in the country.

---

[1] The A.B.A.'s motion for leave to file its brief as *amicus curiae* was granted on October 26, 1971.

During the years since World War II, the commercial banking industry has invested increasingly large amounts in the field of consumer and mortgage lending. In 1970 commercial banks made consumer loans totaling $39.1 billions and $37.9 billions of such loans were repaid. On December 31, 1970 the total of such loans outstanding amounted to almost $42 billions. On December 31, 1970 commercial banks held $42.4 billions of mortgages on one to four-family houses.

These consumer loans and residential mortgages are made under the provisions of applicable state and Federal laws, including the various titles of the Consumer Credit Protection Act (P.L. 90-321; 15 U.S.C. 1601), state usury statutes, and other state and Federal laws providing and restricting creditors' remedies and debtors' rights.

The banking industry, while highly regulated by both Federal and state authorities, is composed of privately financed institutions which must earn sufficient income to pay their expenses and to yield for their stockholders an adequate return on their investments. So, although banks are called on frequently to perform various functions on a public interest basis, for no charge or for charges less than sufficient to pay the cost of those functions, in the long run they must recover an adequate return on each major segment of their operations, including such major segments as consumer or mortgage loans. In other words, the aggregate finance charges for various classes of consumer and mortgage loans must be sufficient to cover the cost of funds to the lender, the cost of making, administering and collecting loans, and the losses incurred, together with a profit sufficient to induce the

lender to undertake and carry on the business. An increase in the cost of lending or in the ratio of losses to loans will either increase the finance charge which must be borne by the consumers who repay the loans, or eliminate from the category of prospective borrowers or purchasers those persons presenting the highest cost of collection or the highest risk of loss. An increase in the finance charge will impose an additional burden on the vast majority of consumers who repay their loans without delay or default. An increase in the qualifications of prospective customers will compel those eliminated from consideration by any class of lenders to go to higher cost lenders, possibly to loan sharks, or to go without the consumer goods or home improvements they would like to buy.

Achieving and maintaining a fair and acceptable balance between the interests of borrowers and of lenders in this situation is essential, but it is not easy or simple.

The banking industry is concerned over the possibility that the many interrelated factors which must be considered in order to achieve and maintain such a balance may not be taken into account in this case and other cases involving attempts to invalidate significant elements of this balanced consumer financing structure on broad constitutional grounds.

SUMMARY OF ARGUMENT

The American Bankers Association is primarily concerned with the broad approach and sweeping results indicated by the appellants, by various *amici*, and by the Court's stay, issued April 21, 1971.

As a general rule, The American Bankers Association, as a nationwide trade association, does not take

an active part in legislation or litigation relating only to a single state, viewing such matters as of concern to the banks and banking association of that state. However, in the pending case, it appears that constitutional and other issues are raised, the significance of which far transcends the questions raised by the Pennsylvania confession of judgment procedures.

Accordingly, The American Bankers Association presents to this Court background information on the consumer credit industry, on consumer and mortgage financing, and on current legislative developments, which it is hoped will help the Court in deciding these issues.

Further, The American Bankers Association, as indicated in its motion for leave to file this brief, will present arguments:

(1) in support of the District Court's ruling that the waiver of notice permitted under the Pennsylvania confession of judgment procedure is not unconstitutional when entered into "intentionally, understandingly, and voluntarily";

(2) in support of the District Court's ruling that the procedure established by that Court, to insure that in individual cases such waivers were entered into "intentionally, understandingly, and voluntarily", should be applied prospectively and should not invalidate judgments already entered;

(3) in support of the District Court's ruling that no substantial evidence had been introduced in this case indicating any need for a similar procedure in cases involving real estate mortgages;

(4) in opposition to the position set forth in this Court's stay, issued April 21, 1971, prohibiting

execution on and sale of real or personal property under any judgment based on an instrument containing a waiver of notice and other rights under the Pennsylvania confession of judgment procedure, even though the judgment in question was not obtained by means of the confession of judgment procedure, but through regular adversary proceedings; and,

(5) in opposition to the position indicated in the briefs submitted by *amici* California Rural Legal Assistance, et al., and *amicus* National Consumer Law Center to the effect that this Court should, in this proceeding, review the so-called confession of judgment procedures of California and similar procedures in other unspecified states.

We shall seek to do so as briefly as possible, referring primarily to the briefs submitted by the Pennsylvania Bankers Association, the Pennsylvania Credit Union League, the Pennsylvania Savings and Loan League, and the Pennsylvania Land and Title Association.

BACKGROUND INFORMATION

CONSUMER CREDIT

Consumer credit represents a significant proportion of the outstanding private debt in the United States. It is extended by a variety of lending institutions, including personal and sales finance companies, credit unions, and commercial banks, and is used to purchase a wide range of goods and services. It is an integral part of our nation's economy. (Home mortgage credit, usually the largest single item of consumer credit, is treated separately below because of its special charac-

teristics and for the most part is not included in the following discussion of consumer credit.)

Direct consumer lending practices developed and grew in this country because lenders in many competing financial institutions were able to make a profit on consumer loans. In the past, one important fact in this profitability was that losses on consumer loans were relatively small. A change in this one fact can substantially affect the entire consumer lending business.

Growth and Importance

One financial observer has said that the consumer loan market ". . . was born in the early 1900's, grew up in the 1920's, and matured in the 1930's".[1] To continue the metaphor, it could also be said that the consumer loan market attained major stature in the post-World War II period. In 1945, total consumer credit outstanding was only slightly in excess of $5.5 billions. By the end of 1970, however, it had increased to $125 billions, accounting for more than 20 percent of all individual and noncorporate debt and only slightly less than 10 percent of the total private debt outstanding (including that of private corporations). The percentages at the end of World War II were 16 and 6½, respectively.

---

[1] Robert P. Shay, "Major Developments in the Market for Consumer Credit Since the End of World War II," *Journal of Finance,* May 1966, p. 369. For a discussion of consumer credit in general, see: U.S. Board of Governors, Federal Reserve System, *Consumer Instalment Credit,* Govt. Print. Office, Washington, D.C., 1957; Paul McCracken, *Consumer Instalment Credit and Public Policy,* Univ. of Michigan, Ann Arbor, Michigan, 1965; and American Bankers Association, *Instalment Credit,* 1964.

The extension of consumer credit on an instalment basis had its genesis in the early 1900's. Prior to that time, capital had not been attracted to any large degree into the cash credit business. Instalment sales financing, in which credit was extended indirectly to borrowers by means of purchasing the instalment contract or note from the seller of merchandise, had been widely used, however. Indeed, as early as 1850 the Singer Sewing Machine Company was making extensive use of an instalment plan, and others soon followed. However, low interest ceilings imposed under existing usury statutes made direct instalment lending unprofitable.

The practice of direct instalment lending, under which credit is extended by an institution directly to a borrower, did not develop on a major scale until the early 1900's, when many states established small loan laws and relaxed their usury statutes.[2] As a result, funds were diverted to the consumer loan market from other money markets. Credit unions, industrial banks (Morris Plan Banks), and consumer finance companies were established and became the primary institutions serving the borrowing needs of the consuming public.

The growth of the nation's distribution and production capacity during this early period of the 1900's also played an important role in the growth and development of these institutions. Similarly, the upsurge in the consumption of goods and services by households

[2] In 1911, the Russell Sage Foundation paved the way for direct lending to consumers by helping Massachusetts draft a comprehensive small loan law, which other states followed in enacting. See The American Bankers Association, *Instalment Credit*, p. 4.

during the post-World War II period resulted in a significant increase in the use of consumer credit. Personal consumption expenditures had increased by more than fourfold from $121 billions in 1945 to more than $615 billions in 1970. More to the point, those types of consumer expenditures which represent so-called "household capital" (automobiles, furniture, and household equipment) and depend to a large extent on the extension of credit for their formation, increased even more rapidly during the postwar period. Indeed, if consumer expenditures on residential construction are included, consumer capital expenditures began exceeding expenditures for producer capital as early as 1950. Much of this household capital formation has depended on the extension of consumer credit, particularly instalment lending.[3]

Initially, the rise in consumer expenditures following World War II reflected the demand for durable goods on the part of consumers which had largely gone unmet, as resources were diverted to meeting the war effort. The diversion of resources from meeting consumer demand to meeting military requirements was accomplished in large part by the establishment in 1941 of consumer credit controls, in the form of Regulation W, which set limits on downpayments and maturities in order to discourage the use of credit for consumer purposes. As a result consumer credit

---

[3] Shay, "Major Developments in the Market for Consumer Credit Since the End of World War II," pp. 370-71.

outstanding was cut nearly in half between 1941 and 1945.[4]

In the absence of these controls during the postwar period, consumer credit grew rapidly. In part, this was a reflection of the absence of controls themselves. To a greater degree, however, it was a reflection of the tremendous industrial capabilities which emerged for producing goods on a mass scale, rising consumer expectations and demand induced by mass-media advertising, and the increased consumer willingness to use, and ability to obtain, credit for the purpose of purchasing consumer items.

Reflecting these and other factors, consumer instalment credit has increased substantially since the end of World War II. From $4.5 billions in 1939, consumer instalment credit increased to more than $100 billions in 1970, as shown in Table 1. The largest share of consumer instalment credit extended during this period financed the purchase of automobiles, although the share which auto financing makes up of the total has declined somewhat since the mid-1950's, as shown in the table. Loans used to purchase all other consumer goods have diminished somewhat in relative importance since the early postwar period, while the relative importance of personal loans has increased.

---

[4] The imposition of priority and allocation controls including rationing, which virtually or completely eliminated the manufacturing of automobiles and other consumer goods for the civilian market, was also a major factor in this development.

Table 1

TOTAL INSTALMENT CREDIT, 1939-70

End of Year	Total	Automobile Paper	Other Consumer Goods Paper	Repair and Modernization Loans	Personal Loans
		Millions of Dollars			
1939	$ 4,503	$ 1,497	$ 1,620	$ 298	$ 1,088
1945	2,462	455	816	182	1,009
1950	14,703	6,074	4,799	1,016	2,814
1955	28,906	13,460	7,641	1,693	6,112
1960	42,968	17,658	11,545	3,148	10,617
1965	71,324	28,619	18,565	3,728	20,412
1970	101,161	35,490	29,949	4,110	31,612
		Percentage Distribution			
1939	100.0%	33.2%	35.9%	6.6%	24.2%
1945	100.0	18.5	33.1	7.4	41.0
1950	100.0	41.3	32.6	6.9	19.1
1955	100.0	46.6	26.4	5.9	21.1
1960	100.0	41.1	26.9	7.3	24.7
1965	100.0	40.1	26.0	5.2	28.6
1970	100.0	35.0	29.6	4.1	31.2

Source: Board of Governors, Federal Reserve System.

In addition to the large increase which occurred in consumer instalment credit during this period, a significant change also occurred in the source of loanable funds for consumer purchases during the postwar period. As shown in Table 2, both commercial banks and credit unions became relatively more important as consumer lenders. At the end of 1939, for example, commercial banks held 24 percent of the total consumer credit outstanding. During the postwar years, however, commercial banks rapidly increased their

holdings of consumer loan paper, and by 1970 held more than 41 percent of the total, as shown in Table 2.

Table 2

CONSUMER INSTALMENT CREDIT BY SOURCE OF FUNDS, 1939-70

End of Year	Total	Financial Institutions: Total	Commercial Banks	Finance Companies	Credit Unions	Other	Retail Outlets
			Millions of Dollars				
1939	$ 4,503	$ 3,065	$ 1,079	$ 1,836	$ 132	$ 18	1,438
1945	2,462	1,776	745	910	102	19	686
1950	14,703	11,805	5,798	5,315	590	102	2,898
1955	28,906	24,398	10,601	11,838	1,678	281	4,508
1960	42,968	36,673	16,672	15,435	3,923	643	6,295
1965	71,324	61,533	28,962	24,282	7,324	965	9,791
1970	101,161	87,064	41,895	31,123	12,500	1,546	14,097
			Percentage Distribution				
1939	100.0%	68.1%	24.0%	40.8%	2.9%	0.4%	31.9%
1945	100.0	72.1	30.3	37.0	4.1	0.8	27.9
1950	100.0	80.3	39.4	36.1	4.0	0.7	19.7
1955	100.0	84.4	36.7	41.0	5.8	1.0	15.6
1960	100.0	85.3	38.8	35.9	9.1	1.5	14.7
1965	100.0	86.3	40.6	34.0	10.3	1.4	13.7
1970	100.0	86.1	41.4	30.8	12.4	1.5	13.9

Source: Board of Governors, Federal Reserve System.

The increased willingness on the part of commercial banks to make consumer loans reflects a number of factors. In the first place, weak demand for business loans during the 1930's induced banks to search for alternative loan outlets. The favorable repayment record of households during World War II, when many had expected defaults to increase, induced banks to shift additional funds to consumer lending. Banks

realized that prudent lending procedures could result in low losses on consumer loans, thus improving the profitability of establishing or expanding consumer loan departments. Furthermore, consumer loans had a higher yield rate relative to other loans, thereby enhancing profitability. Finally, the massive increase in the production and consumption of consumer goods heavily dependent on credit extension resulted in the volume of credit needed to make mass-financing techniques by banks feasible. In sum, the initial involvement of commercial banks in consumer financing during the prewar period represented a decision to divert funds from the competing alternative of making business loans in the anticipation of realizing greater yields in the consumer loan market. Furthermore, the increased involvement of both commercial banks and credit unions in providing consumer instalment credit reflected the more favorable terms on which they extended credit relative to other competing institutions.[5]

Commercial banks have extended credit to consumers in a variety of ways. The first has been to make a loan directly to a consumer for the purpose of purchasing a good or obtaining a service. The second has been to purchase instalment paper from dealers in durable goods, thus making funds available to the consumer indirectly. The third way is even more indirect. It has involved making funds available to sales finance or personal loan concerns. These concerns in turn purchase consumer instalment paper themselves or make loans directly to consumers.[6]

---

[5] See Paul F. Smith, *Consumer Credit Costs, 1949-59* (Princeton, N.J.: Princeton University Press, 1964).

[6] See Roland I. Robinson, *The Management of Bank Funds,* New York, 1962, pp. 265-85.

While commercial banks have increased their holdings of consumer loans during the postwar period, they continue to rely heavily on purchasing consumer loans from another party. Indeed, as shown in Table 3, commercial banks hold a larger share of their automobile paper in the form of loans purchased from other lenders than in loans they have made directly to consumers. In 1970, for example, nearly 30 percent of the consumer loans held by commercial banks were in purchased automobile paper, while little more than 18 percent were held in automobile loans made directly.

Table 3

CONSUMER INSTALMENT CREDIT HELD BY COMMERCIAL BANKS

End of Year	Total	Automobile Paper: Purchased	Automobile Paper: Direct	Other Consumer Goods Paper	Repair and Modernization Loans	Personal Loans
			Millions of Dollars			
1939	$ 1,079	$ 237	$ 178	$ 166	$ 135	$ 363
1945	745	66	143	114	110	312
1950	5,798	1,177	1,294	1,456	834	1,037
1955	10,601	3,243	2,062	2,042	1,338	1,916
1960	16,672	5,316	2,820	2,759	2,200	3,577
1965	28,962	10,209	5,659	4,166	2,571	6,357
1970	41,895	12,433	7,587	8,633	2,760	10,482
			Percentage Distribution			
1939	100.0%	22.0%	16.5%	15.4%	12.5%	33.6%
1945	100.0	8.9	19.2	15.3	14.8	41.9
1950	100.0	20.3	22.3	25.1	14.4	17.8
1955	100.0	30.6	19.5	19.3	12.6	18.1
1960	100.0	31.9	16.9	16.5	13.2	21.5
1965	100.0	35.2	19.5	14.4	8.9	21.9
1970	100.0	29.7	18.1	20.6	6.6	25.0

Source: Board of Governors, Federal Reserve System.

Although commercial banks are relatively more important as providers of consumer credit at the present time compared with the earlier postwar years, they have tended in recent years to maintain consumer loans at a given percentage of total loans, with consumer loans as a percentage of all loans at commercial banks not increasing substantially since early 1950. As shown in Table 4, consumer instalment loans as a percentage of all loans of insured commercial banks stood at slightly more than 15½ percent in 1970, compared with about 12½ percent in 1950. Thus, the relative increase in the importance of commercial banks in the consumer loan market has reflected the general upward rise in the availability of funds for lending purposes at commercial banks which occurred during the postwar period, rather than any major diversion of funds to consumer loans from other competing intra-bank uses. However, consumer instalment loans do represent a larger share of all loans made by commercial banks in the postwar period compared with that of the prewar years.

Table 4

LOANS TO INDIVIDUALS HELD BY INSURED COMMERCIAL BANKS, 1945-70

End of Year	Total Loans	Loans to Individuals		Loans to Individuals as a Percentage of Total Loans	
		Instalment[1]	Single-Payment	Instalment	Single-Payment
	(Millions of Dollars)				
1945	25,769	$ 889	$ 1,472	3.4%	5.7%
1950	52,482	6,584	3,477	12.5	6.6
1955	83,628	11,920	5,238	14.3	6.3
1960	119,878	18,655	7,722	15.6	6.4
1965	142,718	21,183	9,340	14.8	6.5
1970	314,142	49,075	16,929	15.6	5.4

[1] Includes bank credit cards and related plans.

Source: Federal Deposit Insurance Corporation.

The ability of commercial banks and other lenders to increase their holdings of consumer loan paper has reflected a greater willingness and ability on the part of households to incur additional debt for the purchase of "household capital". The willingness to incur larger debt for such purposes reflects not only an increased ability to service outstanding debt but also a change in attitude regarding debt and a general unwillingness to set aside funds before purchasing expensive household capital items. In essence, buying such items by using credit is "forced savings" out of income. The increased willingness to incur instalment debt also reflects a greater degree of wealth among households that not only can be used for pledging as collateral in making loans, but adds to the consumers' feelings of general financial well-being and capability of handling increased obligations.

The willingness on the part of the consumer to incur increased debt is clearly borne out in Table 5. As shown in that table, consumer instalment credit has increased substantially compared to consumer income. In 1939, for example, consumer instalment credit outstanding was equal to 6½ percent of disposable personal income in that year. By 1970, however, consumer instalment credit outstanding represented over 14½ percent of disposable personal income that year. These figures clearly show that consumers have increased their debt obligations, at least those for instalment credit purposes, more rapidly than they have increased their income, and that a greater share of presently-earned income is used to service household debt.

Table 5

CONSUMER INSTALMENT CREDIT OUTSTANDING AND DISPOSABLE PERSONAL INCOME, 1939-70

Year	Consumer Instalment Credit Outstanding at Year End	Disposable Personal Income	Consumer Instalment Credit Outstanding as a Percentage of Disposable Personal Income
	(Millions of Dollars)		
1939	$ 4,503	$ 70,329	6.4%
1945	2,462	150,246	1.6
1950	14,703	206,940	7.1
1955	28,906	275,348	10.5
1960	42,968	350,044	12.3
1965	71,324	473,240	15.1
1970	101,161	687,773	14.7

Source: Board of Governors, Federal Reserve System, and Office of Business Economics, U.S. Department of Commerce.

It should be pointed out, however, that the increased use of instalment credit relative to income by consumers is not an isolated phenomenon, but reflects a willingness of households to incur more debt in general. That is to say, consumer instalment debt has not increased relative to other household debt during the postwar period. As shown in Table 6, consumer instalment credit accounted for 21 percent of the total liabilities of households in 1970 compared with 19 percent in 1950.

Table 6

TOTAL LIABILITIES OF HOUSEHOLDS, 1945-70

End of Year	Total	Credit Market Instruments				All Other
		Mortgages	Consumer Credit		Bank Loans N.E.C. and Other Loans	
			Instalment	Noninstalment		
		Billions of Dollars				
1945	$ 35.0	$ 18.5	$ 2.5	$ 3.2	$ 4.8	$ 6.0
1950	77.4	45.0	14.7	6.8	6.7	4.4
1955	144.9	89.8	28.9	9.9	8.5	7.7
1960	226.2	146.0	43.0	13.2	14.2	9.9
1965	349.4	220.6	71.3	19.0	22.9	15.5
1970	482.0	293.1	101.2	25.6	41.7	20.5
		Percentage Distribution				
1945	100.0%	52.9%	7.1%	9.1%	13.7%	17.1%
1950	100.0	58.1	19.0	8.8	8.7	5.7
1955	100.0	62.0	20.0	6.8	5.9	5.3
1960	100.0	64.5	19.0	5.8	6.3	4.4
1965	100.0	63.1	20.4	5.4	6.6	4.4
1970	100.0	60.8	21.0	5.3	8.7	4.3

Source: Board of Governors, Federal Reserve System.

Credit Factors and Consumer Loans

There is always an element of uncertainty, of course, in any credit transaction. Creditors can never be absolutely certain that debtors will fulfill their end of the obligation by repaying the loan. Most lenders, therefore, try to evaluate prospective borrowers critically in order to determine ahead of time whether or not the probabilities are that the debtor will be able to repay the obligation. It must be recognized that creditors will always suffer some losses on a number

of transactions and for this reason must be willing to set aside adequate reserves and be willing to accept some losses and charge-offs.

The factors which determine a good credit risk in instalment lending are fairly well known and widely used by creditors. For example, in a study conducted by the National Bureau of Economic Research in 1941 [7] it was found that one of the most important indicators of the borrower's credit dependability was stability of residence. For instance, those borrowers who had lived at the same address for 6 years or more had a better than average record on loan repayment. In addition, tenure in employment showed similar positive indications of credit worthiness, as did permanence in employment. In both of these cases, stability appeared to be the best test of a good borrower. It was also found that borrowers owning securities, a bank account, or some real estate had better than average credit records. The study also showed that income was an important, but not a conclusive, factor in reducing risk in the extension of consumer credit. Other than those borrowers with very sizeable incomes, whose risks were markedly below average, differences in credit worthiness could not be determined for other income groups. That is to say, income did not provide an adequate indicator of credit performance on the part of consumer borrowers. Other factors, such as the age of the borrower, marital status, sex, or number of dependents did not show any conclusive relationship to credit experience or worthiness.

---

[7] David Durand, *Risk Elements in Consumer Instalment Financing* (Princeton N.J.: Princeton University Press, 1941).

In a study by Paul Smith[8] of the direct instalment loans made by one commercial bank from 1952 to 1958, it was found that an inverse relationship existed between delinquency rates and loan maturity, borrower's income, age, length of time in last residence, and time on last job. Higher delinquency rates were found for renters than for homeowners, for those with no telephone, for persons without a bank account, and for men than for women borrowers.

Similar results with respect to repossession rates on new cars financed by a large sales finance company were reported in another study.[9] Repossession rates were found to vary positively with the maturity of loans for the purchase of new cars, but inversely with that for used cars. They also showed a positive relationship to the percentage of new car costs financed, but inversely with the percentage financed on used cars. The results for income, age, length of residence and employment, homeownership, occupation, and marital status were similar to those found in the study by Paul Smith.

In an even more recent study conducted by the National Bureau of Economic Research,[10] it was found that higher downpayment requirements were consistently associated with lower delinquency, repossession, and loss rates. In the case of new auto loans,

---

[8] Paul F. Smith, "Measuring Risk on Instalment Credit," *Management Science*, November 1964, pp. 327-340.

[9] Paul W. McCracken, *Consumer Instalment Credit and Public Policy* (Ann Arbor, Michigan, 1965).

[10] Geoffrey H. Moore and Philip A. Klein, *The Quality of Consumer Instalment Credit* (New York: National Bureau of Economic Research, 1967).

shorter maturities were associated with smaller risk of credit difficulty. In the case of used cars, short maturities typically have been associated with poorer credit performance.

Using data taken from a 1954-55 survey of new-car financing by the Federal Reserve Board, the National Bureau study concluded that the highest rates of collection difficulty were for borrowers with zero or negative net worth, borrowers with no liquid assets, and borrowers with incomes under $3,000 (along with the unemployed). The lowest rates were for married borrowers under 45 with no children, for farm operators and clerical and sales personnel, and for borrowers with high income and substantial liquid assets. Thus, the study concluded the ultimate outcome of a consumer loan is related to credit terms such as maturity and especially downpayment, while such characteristics of borrowers as income, liquid-asset holding, and "life-cycle status" also bear a relationship to repayment experience.

The purpose of such studies has been to identify those factors which creditors can use to indicate, in all probability, the degree of repayment risk involved in extending credit to a prospective borrower. Thus, by considering carefully the terms on which loans are offered and by determining the characteristics of the prospective borrower, the lender is capable, in very broad terms at least, of determining some degree of credit risk. The ability to foretell risk and reduce losses is central to providing an adequate rate of return on consumer loans and thereby help to assure a continued flow of funds for consumer lending purposes.

The Consumer Loan Contract

The extension of credit to consumers for the purchase of goods or services on an instalment basis typically involves the use of some form of security instrument. This may take the form of either a conditional sales contract, a chattel mortgage, or a bailment lease. Under a conditional sales contract, which is the most widely used form of contract, full ownership of the item purchased by the borrower is transferred to him when all instalments on the loan have been made, possession of the item is with the borrower during the repayment period, and authority of the creditor to repossess the goods purchased is granted in event of default. In about half of the cases of instalment transactions made by a retail seller, the debt paper is sold to either banks or sales finance companies.

Most lenders use a standard contract in extending consumer credit. The use of such standardized contracts serves a useful economic function. For one thing, they allow the lender to process a large volume of loans in a simple and time-saving manner. Thus, costs are reduced and greater incentive exists for allocating funds into the consumer loan market than if the contract for each transaction had to be handled on an individual basis. In a word, standardized contracts permit automatic processing of transactions, thereby resulting in a greater savings in time, effort, and cost on the part of lenders. In addition, administration and planning for risk is improved by the standardized contract. Furthermore, such contracts more effectively use the lessons of past loan experience in order to reduce risk and possible losses.

In order to provide additional security on instalment loans, lenders frequently use a variety of clauses that further reduce the risk of loss in the case of delinquency or nonrepayment.[11] These clauses may be included in consumer loan contracts where some form of consumer good is involved, but they take on even more importance in the case of personal loans where the loan is unsecured. These clauses may take the form of a separate promissory note, a judgment note, or a wage assignment. Not all of these clauses are permitted by state law, however. Even where included they may not be strictly enforced by the creditor, but may be used in an effort to remind the borrower of his obligation and thereby avert a possible loss.

The Loss Experience

No matter how well a creditor has screened prospective borrowers when extending credit, losses are bound to occur. Estimates are, however, that 90 percent of the accounts will be repaid on time and in full. In the remainder of the cases, the account may become delinquent as a result of legitimate problems suffered by borrowers. These could include illness, strikes, loss of employment, marital difficulties, or other factors that may be outside the control of the debtor. In most cases, the creditor will attempt to restructure the

[11] In its list of contract provisions and creditors' remedies, included in part III of its questionnaire, the National Commission on Consumer Finance included waiver of buyer defenses, acceleration provisions, wage assignments, cross collateral, confessions of judgment, attorney fees, security interests or repossessions, and "other". See page 13 of the A.B.A.'s motion for leave to file this brief.

debtor's obligation to fit his needs and allow payment to be made or to postpone the obligation until it can be fulfilled. In cases involving fraud and deceit on the debtor's part, the creditor takes action to avoid having to realize a loss on the debt. The creditor may be able to repossess the consumer item which was purchased and used as collateral by the borrower. In other cases, where collateral does not exist, the lender may resort to filing suit for repayment. In many cases, the creditor may consider that the time and expense involved do not warrant attempts to carry the collection process to that extreme, and he may be content to write the loan off at a loss. Such a loss increases the costs of supplying funds by the creditor and, unless offset by a higher yield on loans made to other borrowers, will reduce the creditor's incentive to supply additional funds for consumer loan purposes.

Generally speaking, loss experience has declined somewhat during the post-World War II period. For example, in the 1947-51 period the delinquency rate on consumer instalment loans was over two percent of the loans outstanding at commercial banks. However, in recent years it has averaged less than two percent, as shown in Table 7. As also shown in the table, delinquency rates on consumer loans have been subject to rather wide swings during the postwar period. Generally, rates have been higher during postwar periods of economic contraction. Thus, delinquency rates in the periods of 1948-49, 1953-54, 1957-58, 1960-61, and 1970 have averaged somewhat higher than in other periods characterized by business expansion.

Table 7

PERCENT OF CONSUMER INSTALMENT LOANS AT COMMERCIAL BANKS DELINQUENT 30 DAYS AND OVER

Year	Rate	Year	Rate
1947	2.40	1959	1.65
1948	2.02	1960	1.76
1949	2.67	1961	1.68
1950	2.09	1962	1.64
1951	2.15	1963	1.76
1952	1.92	1964	1.70
1953	1.98	1965	1.65
1954	1.65	1966	1.75
1955	1.50	1967	1.71
1956	1.52	1968	1.67
1957	1.57	1969	1.67
1958	1.55	1970	1.85

Source: Instalment Credit Committee, American Bankers Association.

Indeed, one study on the consumer loan market has concluded that "... the general health of the country is probably the most important variable affecting loan experience ...."[12] The authors of that study pointed out that not only delinquency rates, but repossession and loss rates, as well, rise during recessions and fall during expansions. This turn of events is clearly understandable. When hours of work are reduced and unemployment rises, income declines. Debtors who suffer loss of income find it difficult to make repayment on loans which they have made. A definite sequence of events appears to occur with regard to credit difficulties in periods of business contraction. Understand-

[12] Moore and Klein, *The Quality of Consumer Credit*, p. 133.

ably, delinquent accounts emerge initially, followed by an increase in repossessions, and finally in loan charge-offs and losses. Collection difficulties first manifest themselves when monthly payments become overdue, which may then lead to voluntary or involuntary repossession of the article securing the loan (if there is any), and its eventual sale, and the final write-off of losses on the creditor's books. Even in the case of a sale of the repossessed article, a loss may have been incurred by the creditor, since it may have been resold in a market characterized by falling prices on used durable goods in a business recession. Depreciation of the article may also tend to reduce its resale value below the initial dollar amount borrowed.

It is difficult to determine what this loss experience over the course of postwar business cycles may have meant in terms of the dollar costs of consumer credit. It is to be expected that the increase in losses and charge-offs experienced toward the end of postwar contractions and during business contractions would result in higher costs to creditors and, if not absorbed by creditors, in higher costs to prospective consumer loan customers. Yields on consumer loans, however, tend to be high toward the end of expansions and lower during business contractions for reasons associated primarily with the demand for such loans, overshadowing those on the costs side resulting from higher loan losses.

It should also be noted that loss experience on consumer loans varies widely by type of lending institution. It has been shown, for example, that loan losses at commercial banks are significantly below those for other consumer lending institutions. For example, in

a study of consumer credit costs from 1949 to 1959, losses on consumer credit at commercial banks ran only 15 cents per $100 of outstanding credit. As shown in Table 8, this was substantially less than that experienced by credit unions and other institutions.

Table 8

LOSSES ON CONSUMER CREDIT BY LENDER, 1959

(Dollars per $100 of Average Outstanding Credit)

	Actual Losses [1]
Nine Commercial Banks	.15[2]
All Federal Credit Unions	.38
Ten Sales Finance Companies	1.11
Nine Consumer Finance Companies	1.70

[1] Net of recoveries.

[2] Somewhat higher bank losses are shown in Table 9 below.

Source: Paul F. Smith, *Consumer Credit Cost, 1949-59*, A Study of the National Bureau of Economic Research, (Princeton, N.J.: Princeton University Press, 1964).

It should be pointed out that this is not a complete indication of the total costs of risks and it understates the cost differential associated with different degrees of risks. It does not include losses sustained by dealers under recourse agreements, nor the differentials in the costs of investigation and collection associated with differences in credit quality. Many of the costs of handling high-risk loans, therefore, cannot be segregated from the rest of the various operating expenses. One observer has pointed out that "If all costs associated with variations in risk could be isolated, risks would undoubtedly play a substantial

part in explaining differences in operating costs among lenders."[13]

Pricing Consumer Credit

The price which the borrower pays for obtaining credit reflects the interaction of both the demand for, and the supply of, loanable funds. In the case of consumer credit, the price which the consumer pays for obtaining credit is a reflection of both the willingness on the part of the consumer, therefore, to incur debt for consumption purposes and the costs which creditors incur in providing funds for that purpose. Costs are important from the creditor's standpoint because they help to determine the net yield from alternative avenues of investing and lending and, therefore, the extent to which funds will be allocated among competing ends. In the case of both single-purpose lenders, such as sales and personal finance companies, and multi-purpose lenders, such as commercial banks, an adequate rate of return on consumer lending activities will determine how successfully those institutions will be in competing for overall funds made available from savings in the economy. In the case of multi-purpose lenders, it will determine the extent to which funds will be provided for consumer lending in relationship to other investment and lending alternatives.

A wide variety of costs are involved in the extension of consumer credit, ranging from the direct costs of processing consumer loans and indirect costs associated with general overhead of the business, to the lender's costs of obtaining funds and incurring

---

[13] Smith, *Consumer Credit Costs, 1949-59*, pp. 81-82.

losses on loans extended. The costs shown in Table 9 are illustrative of those incurred by commercial banks in extending credit on an instalment basis. Although the figures shown in that table also include the costs and income for non-consumer instalment loans, as well as those for consumer instalment loans, they are indicative of the types of costs that need to be covered in extending credit to consumers. (Non-consumer instalment debt accounted for less than 10 percent of the total dollar volume outstanding for the banks shown in the table.)

As shown in the table, the lender's cost of money is the largest single cost component in the instalment credit function of commercial banks. Another large component is the costs under processing expenses of which wages, salaries, and benefits comprise the largest share. In addition, some share of the general overhead costs which can be allocated to the instalment loan function is included as a component of overall costs in this department of the bank. In addition to these costs, those arising from losses on loans are also included. As shown in Table 9, losses on loans were in the neighborhood of three and one-half dollars per $1,000 of outstanding instalment loans for these banks. Should any of these costs increase, either net earnings must decline or the increased cost must be passed on to the borrower in the form of a higher cost for credit. In the first instance, that of reducing net earnings, the inducement to place funds in the instalment loan function will be reduced, while in the second instance, that of higher borrower costs, prospective debtors will no longer be as willing or able to service increased debt obligations.

Table 9

COSTS OF INSTALMENT LOAN FUNCTION IN COMMERCIAL BANKS, 1970

(Dollar Cost Per $1,000 of Instalment Loan Portfolio of 1,003 Banks)

Item	665 Banks Less Than $50 M in Deposits	261 Banks $50 M to $200 M in Deposits	77 Banks More Than $200 M in Deposits
Income	$106.39	$105.66	$110.94
Expenses			
Processing Expenses, Total	25.23	27.5[illegible]	34.43
Officers Salaries	7.25	5.90	4.26
Processing Salaries and Wages	9.20	10.56	15.34
Fringe Benefits	2.44	2.63	3.39
Furniture and Equipment	1.03	.87	1.10
Computer Service Expenses	2.01	3.55	4.72
Printing, Stationery, Supplies	1.09	1.14	1.48
Postage, Freight, Delivery	.62	.66	1.07
Telephone and Telegraph	.83	.97	1.31
Fees, Legal and other	.76	1.24	1.76
Overhead Expenses, Total	35.58	37.93	45.97
Publicity and Advertising	2.11	2.04	1.90
Creditors and Other Insurance	1.07	.88	.88
Share of Occupancy Expense	2.76	2.77	3.45
Other	4.41	4.72	5.31
Net Earnings	70.81	67.73	64.97
Losses	3.46	3.14	3.71
Cost of Money	36.68	35.64	38.46
Net Earnings After All Adjustments	30.67	28.95	22.80

Source: Functional Cost Analysis, 12 Federal Reserve Districts, 1970.

Another way of viewing the pricing decisions made in the extension of consumer, or other, credit, is in terms of the *marginal* (or additional) costs involved in extending loans and the marginal *revenue* obtained by doing so. Theoretically at least, the rational creditor will lend up to the point at which the marginal revenue obtained from making an additional loan is just equal to the marginal costs of making that loan. For a bank or any other lender to extend operations to such a scale where the added costs exceeded the added revenue from making one more loan would not be rational from an economic standpoint, since such a decision would result in a loss of revenue. Likewise, it would pay to expand loans if the marginal revenue is exceeding the marginal costs of making a given number of loans. Using this approach to describe the pricing decisions of lenders, it is clear that a rise in costs, for example, in the form of additional loan losses, will increase the marginal costs of extending credit. Unless matched by a proportionate increase in marginal revenue, in the form of a higher price (interest rate) charged to borrowers, credit extension will be reduced and funds diverted to more attractive uses.

In any event, it is apparent that increased loan losses will produce higher costs. The absence of adequate creditors' remedies would, of course, tend to heighten such losses. In any event, such higher costs will result in higher loan costs to the ultimate borrower and/or reduced availability of credit for consumer purposes. Over time, of course, the demand for consumer credit will increase as a result of increased household income and wealth and continued propensity to incur and service a larger debt load. Such a rise in demand, of course, could support the higher price and more than offset the decline in availability of credit which may

result. Nonetheless, the increased costs incurred will be borne by those obtaining such credit and represent a form of income forgone by those same individuals, since in the absence of such costs the price they pay would have been correspondingly lower.

Studies of Effects of Changes in Costs and Changes in Creditors' Remedies

The significance of confession of judgment clauses (and the other creditors' remedies) in the area of costs relates both to the amount of the losses and to the amounts spent on processing costs. These creditors' remedies help to reduce the amounts finally lost, to the extent that repossession or seizure of chattels or real estate and subsequent sale thereof bring in funds, or funds are obtained out of the debtor's wages or co-signer's assets. Probably of even greater importance is the psychological assistance which the knowledge of these creditors' remedies give to a creditor in persuading a delinquent debtor to continue making payments on his loan, instead of using his funds for other purposes, and thereby preventing the loan from ever reaching the point of actual default.

To the extent the knowledge of the existence of these creditors' remedies keeps a debtor from ever becoming seriously delinquent, time and expense in the form of processing costs are saved. To the extent that knowledge of these remedies induces a debtor to pay his debt, even belatedly, the need for repossession or garnishment is reduced. And to the extent these remedies reduce the final loss incurred, the overall expense of the creditor's loan programs is reduced.

An extensive study of the relationship between income and costs in the field of consumer lending, and

its effects on consumers, particularly the marginal consumer, was made at the Graduate School of Business Administration of the University of Washington. This study was reported at length in *The Impact of a Consumer Credit Interest Limitation Law—Washington State: Initiative 245.*

Initiative 245, approved in the State of Washington in 1968, reduced from 18 percent to 12 percent the interest rates on various kinds of consumer credit, particularly bank cards (the 36 percent interest rate for loans under $300 and 18 percent rate for loans from $300 to $500 permitted to small loan companies were not affected). The study reached three conclusions. *First,* the availability of credit was reduced in many cases—lenders' rejection rates rose, applicants were rejected who previously would have been accepted, applicants who were accepted were given lower credit lines, and other applicants were asked to get outside financing for their purchases. *Second,* the price of credit was increased for some consumers—applicants who formerly got 18 percent bank credit were forced to borrow at small loan companies at 36 percent (up to $300) or to go to usurious money lenders at unlimited illegal rates, interest-free open book accounts were changed to interest-bearing revolving credit accounts, and downpayments were increased and maturities decreased in order to lower the risks. *Third,* the prices of products were increased—in some cases the prices of all products, in other cases the prices of credit-sensitive items, and in some cases fees were charged for services formerly rendered without cost.

This study shows the results of a reduction in a lender's income resulting from lowered interest rates. An increase in a lender's costs (higher losses and higher

collection costs, resulting from less effective creditors' remedies) would impose the same pressure on a lender and could be expected to produce the same results.

Further studies in the field of consumer credit, including a survey of the effect of changes in creditors' remedies on the cost and availability of credit, are being made by the National Commission on Consumer Finance, established by Title IV of the Consumer Credit Protection Act. In its report on its current study projects (a copy is attached to this brief as Appendix A), the Commission told about its outline of a survey on creditors' remedies and continued:

> "The Commission expects responses to this outline to help it gauge the possible effect upon the credit granting industry if certain practices or laws were abolished or changed. For example, would abolishing the holder-in-due-course defense make credit less available or more costly? Would it exclude low income consumers from the legitimate credit market? Would it change credit granting criteria and cut off credit to a segment of the population, other than low income consumers, to which it is presently available?
>
> "The Commission believes that it is breaking new ground with this study since to its knowledge no analyses have previously been undertaken to determine what occurs when laws restricting debt collection methods have been enacted."

THE HOME MORTGAGE INDUSTRY

One of the major forms of debt incurred by consumers is the mortgage debt incurred for purchase of their homes. This specialized form of consumer debt, like other consumer debt, has grown rapidly since the end of World War II. It represents, usually, the largest single debt incurred by the consumer during his life-

time, and the aggregate of mortgage debt is of vast importance to home owners generally, to land developers, to the building materials and home building industries, to the building trades, to those financial industries which participate in it, and to the public generally. The growth of mortgage debt, which parallels closely the growth of the home building industry and the supply of homes in the country, is shown by the following table:

Table 10

MORTGAGE LOANS OUTSTANDING ON ONE- TO FOUR-FAMILY NONFARM HOMES, BY TYPE OF LENDER

(Millions of Dollars)

Year-End	Total	Savings and Loan Associations†	Commercial Banks	Mutual Savings Banks	Life Insurance Companies	Federal Government Agencies	Individuals and Others
1950	$ 45,170	$ 13,116	$ 9,481	$ 4,312	$ 8,478	$ 1,468	$ 8,315
1955	88,250	30,001	15,075	11,100	17,661	3,015	11,398
1960	141,287	55,386	19,242	18,369	24,879	7,136	16,275
1961	152,994	62,395	20,038	20,022	25,641	7,310	17,588
1962	166,482	69,761	22,129	22,149	26,374	7,359	18,710
1963	182,187	79,058	24,910	24,717	27,331	6,169	20,002
1964	197,577	87,172	27,220	27,394	28,525	6,001	21,265
1965	212,937	94,225	30,401	30,064	29,589	6,396	22,262
1966	223,645	97,423	32,803	31,673	30,233	8,876	22,637
1967	236,060	103,327	35,275	33,467	29,763	10,730	23,498
1968	251,241	110,295	38,765	35,047	29,030	13,200	24,904
1969	266,823	117,990	41,356	36,443	27,964	17,062	26,008
1970	279,739	125,268	42,354	37,504	26,581	21,201	26,831

† Beginning in 1966, includes real estate sold on contract; 1967 and 1968 data exclude mortgage holdings of several associations in liquidation.

Source: Federal Home Loan Bank Board. See FHLBB Journal, Oct. 1971, p. 39.

CURRENT LEGISLATION

The consumer lending business, including mortgage lending, involves a closely interrelated series of rights and obligations which cannot be treated in isolation. Eligibility of borrowers, interest rates, security requirements, collection practices—all constitute a single integrated structure, and any change in one element may make it desirable or essential to make compensating changes in other elements.

The banking industry is convinced that a desirable balance between the interests of borrowers and of lenders can be achieved and maintained better through the legislative process than through litigation based on broad constitutional principles, which may not be susceptible of flexible application to particular circumstances, and which, in any event, cannot affirmatively amend statutory provisions so as to compensate for changes made in related statutes by judicial interpretation or invalidation.

A legislature can develop all the facts needed to reach a sound balance of the competing pressures and interests. A legislature can also change statutory benefits and burdens in various elements of the consumer lending structure to accommodate the changes it makes in other elements in the structure. A court cannot amend usury statutes and change maximum interest rates as the Uniform Consumer Credit Code would do; a court cannot amend the National Bank Act and increase or decrease the proportion of the appraised value of a house that a national bank may lend to the purchaser of the house; a court cannot increase or decrease the amounts small loan companies, credit unions, savings institutions, or commercial banks may lend on a consumer or mortgage loan.

The Congress and state legislatures have felt the need for action in this field.

During 1969 and 1970 hundreds of statutes were enacted by state legislatures affecting creditors' remedies and debtors' rights. Six states have enacted the Uniform Consumer Credit Code with more or less extensive amendments.[15] Many states have also established special committees or commissions to study these issues and to make recommendations to their state legislatures.

The principal Federal statute in the field is the Consumer Credit Protection Act (82 Stat. 146, 15 U.S.C. 1601), enacted May 29, 1968, after a series of extensive hearings beginning in 1960. Title I of this act, the Truth in Lending Act, provided for consumer credit cost disclosure; Title II prohibited extortionate credit transactions; Title III contained restrictions on the garnishment of wages and salaries; and Title IV created a National Commission on Consumer Finance.

In 1970, additional consumer legislation was enacted —the Fair Credit Reporting Act (Title V, P.L. 91-508), and a prohibition on distribution of unsolicited credit cards and other credit card provisions (Title V, P.L. 91-508).

In 1971, a new bill involving many consumer credit proposals in the field of credit cards was introduced (S. 652, 91st Congress) and hearings were held on it this past week.

---

[15] Colorado: Rev. Stat. § 73-1-101 (1971); Idaho: Laws 1971, Ch. 299 (effective July 1, 1971); Indiana: Code of 1971 § 19-21-101 (1971); Oklahoma: Laws 1969, Title 14A, § 1-101 (1969).; Utah: Code Annotated, Ch. 9 (1953); Wyoming: Code Annotated § 40-1-101 to 40-9-103 (1971).

NATIONAL COMMISSION ON CONSUMER FINANCE

One of the major provisions of the Consumer Credit Protection Act was Title IV, which created the National Commission on Consumer Finance. This Commission consists of three members of the U.S. Senate, three members of the U.S. House of Representatives, and three private citizens appointed by the President. The Commission was directed to "study and appraise the functioning and structure of the consumer finance industry, as well as consumer credit transactions generally". The Commission was particularly charged with the duty of studying:

"(1) The adequacy of existing arrangements to provide consumer credit at reasonable rates.

"(2) The adequacy of existing supervisory and regulatory mechanisms to protect the public from unfair practices, and insure the informed use of consumer credit.

"(3) The desirability of Federal chartering of consumer finance companies, or other Federal regulatory measures."

The Commission was required to report by January 1, 1971, later extended to July 1, 1972 (P.L. 91-344).

The Commission has undertaken an extensive research program, which was set forth in its release of March 18, 1971, a copy of which is attached as Appendix A.

As part of its program, the Commission recently prepared and sent to thousands of credit grantors, including over 1,200 commercial banks, questionnaires on "Consumer Credit Collection Practices and Cred-

itors' Remedies". (Extracts from the questionnaire sent to commercial banks were attached to the American Bankers Association's Motion for Leave to File this brief, as Exhibit B.) The aims of the Commission in making this survey were stated by the Commission's Executive Director, Mr. Robert L. Meade, as follows:

> "In view of the Commission's desire to appraise objectively and completely all relevant information, the questionnaire has been designed with three aims. *First*, to enable the Commission to understand thoroughly the normal business practices utilized in collecting debts. *Secondly*, to permit the Commission to establish the extent and frequency of use of certain collection practices. *Third*, to ask your assistance in relating to the Commission the experience of your institution in a state or states whose laws either prohibit or restrict certain contractual terms relating to creditors' remedies and collection practices generally, in order that the Commission may ascertain what actual effects, if any, may be expected in the future if such limitations were adopted more widely."

The Congress authorized the National Commission on Consumer Finance to obtain information relating to consumer credit transactions, through this and other studies, in order to get information for the use of Congress in further legislation in this field. It is respectfully submitted that the same kind of information is at least appropriate if not indispensable before broad or radical changes in the consumer mortgage field are made by judicial action.

ARGUMENT

I

The waiver of notice permitted under the Pennsylvania confession of judgment procedure satisfies the constitutional due process requirements when entered into "intentionally, understandingly, and voluntarily"

The Pennsylvania procedures for the entry of judgment on the basis of a confession of judgment clause and for execution on real or personal property on the basis of such judgment require that the debtor be given notice before his property, real or personal, is taken. These procedures are set forth fully in the briefs of the Pennsylvania Bankers Association, the Pennsylvania Credit Union League, and the Pennsylvania Savings and Loan League and no purpose would be served by repeating them here.

The requirement of the 14th Amendment to the Constitution that no person shall be deprived of his property, without due process of law, is satisfied when a person is given a reasonable opportunity for a meaningful and effective hearing as to his rights before his property is taken. This broad constitutional requirement has not been interpreted to require any specific form of hearing at any specific time in the course of the legal proceedings. It is enough if the substance of the benefits of the constitutional provision are given to the debtor. *Boddie* v. *Connecticut*, 401 U.S. 371 (1971); *American Surety Company* v. *Baldwin*, 287 U.S. 156, 168 (1932). While the entry of a judgment by confession places a lien, not wholly unlike a mortgage lien, on a debtor's property, real or personal, it does not in itself deprive the debtor of the property. In any event, only ordinary real or personal property is involved, not personal life or liberty as in a criminal case, or family

4

relationships, *Armstrong* v. *Manzo,* 380 U.S. 545 (1965), or wages—that "specialized type of property presenting distinct problems in our economic system", *Sniadach* v. *Family Finance Corp.,* 395 U.S. 337, 340 (1969). These personal rights, including a person's rights to his wages, may well call for a higher degree of constitutional protection than the property rights involved in the present case.

II

Any ruling in this case which invalidates the Pennsylvania confession of judgment procedure or establishes procedures related thereto should be given only prospective effect and should not apply retroactively

The authority of this Court to refuse retroactive application of its basic constitutional decisions is clearly established. *Johnson* v. *State of New Jersey,* 384 U.S. 719 (1966); *Cipriano* v. *City of Houma,* 395 U.S. 701 (1969).

The catastrophic results of retroactive invalidations of judgments already entered on the basis of confession of judgment clauses, particularly judgments relating to real estate, and the history and development of the authority of this Court to issue rulings with prospective effect only, are fully set forth in the *amicus* brief of the Pennsylvania Land & Title Association.

While the authority of this Court to decree that any of its rulings may be given prospective effect only has been clearly established, the inclusion of such limitations in its decisions indicates that the Court is aware of the quasi-legislative nature of such rulings. It is respectfully submitted that cases of this nature are particularly appropriate for the exercise of judicial restraint.

III

No substantial evidence was introduced indicating any need for the establishment of a procedure in cases involving real estate mortgages to determine whether confession of judgment clauses in such mortgages were entered into "intentionally, understandingly, and voluntarily"

The evidence introduced in the case, largely confined to hearsay evidence, to the effect that debtors who signed contracts which contained confession of judgment clauses did not understand what they were signing, was limited almost entirely to persons who had executed notes or other instruments relating to loans on personal property, not to mortgages on real estate. What little evidence there was concerning real estate mortgages indicated that usually, if not always, mortgagors were represented at closings by lawyers or real estate brokers, who were able, and under a duty, to explain to their clients the significance of all aspects of the documents they were signing, including the confession of judgment clauses.

The mortgage itself, when recorded, creates a lien on the real estate covered, and entry of the judgment only creates a different kind of lien. Neither lien itself deprives the mortgagor of title to, or possession of, his property. Notice to the mortgagor is required after entry of the judgment and before the Sheriff's Sale that deprives him of his property.

The distinctions between the procedures relating to real estate mortgages in Pennsylvania and the procedures relating to other types of credit are set forth in the brief of *amicus* Pennsylvania Savings & Loan League. In the light of the very different circumstances surrounding the drawing up and execution of a mortgage, and the different procedures concerning

the use of confession of judgment in mortgage cases it is respectfully submitted that evidence relating to the borrowing of money or the purchase of household goods or automobiles by individuals is not relevant to or controlling on transactions involving mortgages.

IV

This Court's stay prohibiting execution under any judgment based on an instrument containing a confession of judgment clause, even though the procedure was not used, was unreasonable and should be terminated.

The Court's stay, issued April 21, 1971, prohibited execution on or sale of real or personal property under any judgment based on an instrument containing a waiver of notice and other rights under the Pennsylvania confession of judgment procedure, even though the judgment in question was not obtained by means of the confession of judgment procedure, but through adversary proceedings. This stay apparently is based on the theory that the confession of judgment clause is so inherently vicious that its inclusion in a contract vitiates the contract whether or not it is used.

It is respectfully submitted that even if the confession of judgment procedure is found to be unconstitutional, this stay is unnecessary and inappropriate. If a creditor has for one reason or another given the debtor the benefit of an opportunity to try his case in open court or through adversary summary judgment proceedings, there would seem to be no reason why the obligation found due from the defendant after full adversary proceedings providing all the benefits of due process should be nullified. In fact it does not appear that the appellants seek continuance of this provision.

The effect of such a rule on mortgages and other obligations in Pennsylvania or elsewhere might well have many of the same catastrophic results as are indicated in point III above.

V

Any decision reached by this Court should be restricted to the specific situation before the Court and should not undertake to review and pass upon confession of judgment procedures under California statutes or elsewhere on a nationwide basis

The brief submitted by *amici curiae* California Rural Legal Assistance, et al., cites California statutes and sets forth in detail the legal proceedings relating to two individual *amici curiae*. It appears from references throughout that brief that when these *amici* urge that the judgment of the District Court be reversed, they do so for the purpose of invalidating the California confession of judgment statutes as applied to them, as well as the Pennsylvania confession of judgment procedures as applied to the appellants in this case.

The brief of *amicus curiae* National Consumer Law Center also relies on "its experience on a nationwide basis" and likewise urges that "the deprivation of property by means of confessed judgment is contrary to the public policy of the United States and is unconstitutional". There is no indication that this position is taken otherwise than "on a nationwide basis".

It is respectfully submitted that the Court should refrain from undertaking in this case to pass on the validity of the California confession of judgment procedure which appears to differ substantially from that

of Pennsylvania [16] or on the validity of so-called confession of judgment procedures in Delaware,[17] Ohio,[18] Illinois, Virginia and Wisconsin, all of which also appear to differ substantially in one respect or another from the Pennsylvania procedure.[19] Any decision applicable to other states than Pennsylvania, or to creditors' remedies generally, should be based upon a specific case or controversy involving an actual dispute between parties with differing interests, subject to full adversary briefing and argument by competent counsel representing interested parties affected by the laws of those states, not on the basis of the unverified allegations set forth in the brief of the California *amici* or the "nationwide experience" of *amicus* National Consumer Law Center.

---

[16] California amici concede (their Brief, page 7) that the Pennsylvania type of confession of judgment clause is prohibited in California in contracts for retail instalment sales and for loans by personal property brokers and other loan companies. They point out that the California individual amici agreed to their confessions of judgment after default on the contracts involved (their Brief, page 7). By that time, of course, the debtors presumably knew of any defects in the items purchased, or of any breaches of warranty or failure to perform on the part of the vendors or creditors. And while other California creditors are not expressly prohibited from using confession of judgment clauses in their contracts, we are advised that Section 1133 of the California Code of Civil Procedure requires that a confession of judgment statement be "signed by the defendant, and verified by his oath", that this has been interpreted by the Supreme Court of California as precluding confessions of judgment executed by a person acting as the debtor's attorney, *Barnes* v. *Hilton*, 118 C.A. 2d 108, 257 P.2d 98 (1953), and that as a practical matter this requirement makes contractual confession of judgment clauses impractical for all creditors.

[17] Being considered by this Court in *Osmond* v. *Spence*, October Term, 1971, No. 70-291.

[18] Being considered by this Court in *Overmyer* v. *Frick*, October Term, 1971, No. 69-5.

[19] See Commerce Clearing House, Consumer Credit Guide, Para. 610, Judgment Notes, Vol. 1, pgs. 2301-2311.

On the contrary, the clear indication that parties to this case seek to apply the ruling to be issued herein to the procedures of other states, under other conditions, should, it is respectfully submitted, lead the Court to exercise special care and special restraint in issuing its ruling in this case.

CONCLUSION

It is respectfully submitted that this Court should:

(1) adopt the position taken by the Court below that the Pennsylvania confession of judgment procedure, when agreed to "intentionally, understandingly, and voluntarily", is not unconstitutional;

(2) adopt the position taken by the Court below that any ruling in this case which affects or modifies the Pennsylvania confession of judgment procedure should be given prospective effect only;

(3) adopt the position taken by the Court below that no basis exists for the application of any ruling issued in this case to real estate mortgages;

(4) terminate and dissolve this Court's stay, issued April 21, 1971; and

(5) confine any ruling issued in this case to the Pennsylvania confession of judgment procedure as applied to the circumstances before this Court.

Respectfully submitted,

MATTHEW HALE
General Counsel

The American Bankers Association
1120 Connecticut Avenue, N. W.
Washington, D. C. 20036

November 3, 1971

APPENDIX A

March 18, 1971

Outline of Research Program
National Commission on Consumer Finance

1. The Problem and the Study
2. Structure of the Industry
3. Regulatory Mechanisms
4. Availability
5. Reasonable Rates
6. Disclosure
7. Unfair Practices
8. Effectiveness of Regulatory and Supervisory Mechanisms
9. Information and Education
10. Credit Insurance
11. Federal Chartering
12. The Future of Consumer Credit
13. Summary—Conclusions—Recommendations

* * * * * * * * * *

National Commission on Consumer Finance Report on Current Study Projects

The National Commission on Consumer Finance was directed by Congress to "study and appraise the functioning and structure of the consumer finance industry, as well as consumer credit transactions generally" and to report its findings on:

(1) the adequacy of existing arrangements to provide consumer credit at reasonable rates;

(2) the adequacy of existing supervisory and regulatory mechanisms to protect the public from unfair practices and to insure the informed use of consumer credit; and

(3) the desirability of Federal chartering of consumer finance companies, or other Federal regulatory measures.

To do this adequately, the Commission developed the attached outline based on the statute to serve as a framework for its research.

Since much of the information needed for its studies has been unavailable or in unusable form, the Commission has launched several data collection projects of its own. These and other Commission studies are currently under way.

Traditionally, consumer credit legislation has focused on a specific problem with the idea of correcting a specific abuse. Repeatedly, legislation has been drafted or amended on the basis of these assumptions despite the fact that few if any facts are available on the potential effects of proposals. But this Commission, from the data it gathers, will try to assess the many variables that affect any changes in the "... functioning and structure of the consumer finance industry." Such assessments should provide a basis for legislative bodies, both state and national, to predict with better accuracy the effect on credit grantors and users of proposed laws and regulations to consumer credit. Future legislative and regulatory efforts may thus occur in a context of overall objectives sought and the predictive consequence of particular legislation on these objectives.

The complexity of the consumer finance industry is brought into sharp focus by the Commission's first area of inquiry: "the adequacy of existing arrangements to provide consumer credit at reasonable rates." It has

often been pointed out that credit laws are a patchwork of Federal and state legislation, varying from moderate to extensive state-by-state. The variations among state laws may well be a vital research tool in the Commission's study. Thus, to assess the potential impact of any change in the law on credit grantors and users, the Commission plans to determine the price and amount of credit on a state-by-state basis, including credit generated by banks, retail establishments, credit unions, and finance companies. When these data are gathered, the Commission will attempt to measure the effects of local rate ceilings; state licensing requirements that limit entry of new competition in the consumer finance market; branch banking laws and regulations; and the existence or nonexistence of certain creditor and debtor remedies on the price and amount of credit in each state. To complete this analysis, the Commission will also analyze the statutes and available administrative and case law of each state to determine:

(1) the rate ceilings for each category of credit (i.e., small loans, retail installments sales, etc.) in each state;

(2) the existence or nonexistence of convenience and advantage statutes in each state and whether such statutes are, in fact, barriers to creditor entry in the small credit market;

(3) the existence or nonexistence of branch banking provisions and whether these provisions are barriers to entry; and

(4) which creditor and/or debtor remedies are permitted in each state and how these remedies affect the availability of consumer credit.

To put these data in perspective as well as to fulfill its Congressional mandate, the Commission must also try to determine which segment of the community cannot obtain credit at existing rates and why. After these

data have been gathered and analyzed, the Commission can begin to assess the adequacy of available consumer credit at reasonable rates.

The following is a listing, together with a brief description, of Commission research projects now in progress. Neither the descriptions nor the order are indicative of the relative importance of the studies.

The Commission is conducting a study of the pricing process in the consumer credit industry to try to assess the effect of state laws, government regulation, market structure and demographic and other factors on the price and availability of consumer credit. The survey will collect data on a state-by-state basis (probably using the fourth calendar quarter of 1970) for (1) the total amount of consumer installment credit extended and outstanding, and (2) the average price of such credit. This is the first time that any agency —public or private—has collected finance rate data on a national or state basis for each category of consumer installment credit and the first time that extensions and outstandings have been collected on a state-by-state basis.

This project will enable the Commission to analyze differences in the price and availability of consumer installment credit as they relate to differing state laws (i.e., analysis of the effects of rate ceilings, restrictions on entry, etc.). It will also be available as the Commission attempts to appraise "the functioning and structure of the consumer finance industry" and "the adequacy of existing arrangements to provide consumer credit at reasonable rates." This study should give the Commission insight as to the desirability of Federal chartering.

Another area of Commission research concerns creditors' remedies. During the Commission hearing

in June 1970, several witnesses representing consumer interests recommended curtailment or abolishment of certain collection practices, creditors' remedies, and contractual provisions. To prepare for a possible hearing at which credit industry representatives could discuss these proposals, Commission staff designed a comprehensive data-gathering outline to be completed by a sample of credit grantors representing the existing categories of consumer credit, Basically, the outline was prepared to help the Commission understand practices normally used in debt collection; to compile data establishing the extent and frequency of the use of such practices; and to document the experience of various credit grantors in states which have either abolished or restricted certain creditors' remedies, collection practices or contractual provisons.

The Commission expects responses to this outline to help it gauge the possible effect upon the credit granting industry if certain practices or laws were abolished or changed. For example, would abolishing the holder-in-due-course defense make credit less available or more costly? Would it exclude low income consumers from the legitimate credit market? Would it change credit granting criteria and cut off credit to a segment of the population, other than low income consumers, to which it is presently available?

The Commission believes that it is breaking new ground with this study since to its knowledge no analyses have previously been undertaken to determine what occurs when laws restricting debt collection methods have been enacted.

Another offshoot of the June hearings is a study of automobile repossessions in the District of Columbia. This project was designed to determine the number of repossessions, the nature of repossession

practices, and the effects of repossession—particularly deficiency judgments. Staff researchers were able to trace records of 106 automobiles through court and Motor Vehicle Department files from first financing through repossession, wholesale resale (which establishes the deficiency) and the ultimate retail resale. In each case, actual sale price and NADA Guidebook wholesale and retail values were recorded and the results are now being tabulated for study. The Commission hopes that a comparison of these values will indicate whether "commercially reasonable sales" have taken place. These data, plus data derived from FTC studies designed from the Commission's automobile repossession study format and now being completed in several U. S. cities, should provide information indicating if alternative approaches to the repossession-deficiency process should be considered.

The Commission staff is closely analyzing the Federal Reserve Awareness studies of 1969 and 1970 to assess more specifically the effects of the Truth in Lending legislation on the public. A questionnaire was designed and sent for completion to the nine agencies charged with enforcing Title I of the Consumer Credit Protection Act. Results of this questionnaire should assist in further assessment of the effectiveness of Truth in Lending, as well as the effectiveness of the enforcement activities of the nine agencies.

The Commission has contracted for a study in California of awareness, attitudes, and use of credit by all income groups and by a special sample of low income blacks. This study will attempt to relate the consumers' awareness of finance charges and rates to the decision to purchase goods on a cash or credit basis. It will also determine if consumers consider planning, comparison shopping and present credit ob-

ligations in making their purchasing decisions. Data obtained from this research will be compared with the Federal Reserve Awareness study of December 1970 and with a similar study completed by a Stanford doctoral student in June 1969.

The California study and Commission staff analysis of the Federal Reserve survey should help the Commisson decide whether "existing regulatory and supervisory mechanisms . . . insure the informed use of consumer credit," and whether educational and counseling programs are needed to supplement Truth in Lending.

The Commission has contracted to develop a credit-scoring system for lenders who extend credit to low income borrowers. Currently used systems for screening credit applicants seem to lack the kind of criteria that might provide creditors with information to make better judgments between "good" and "bad" credit risks at the low income level. This project may enable the Commission to assess how much the limitations of present systems restrict credit and to suggest recommendations concerning the design of credit-scoring systems to accommodate more fairly and accurately the low income segments of our population. This study partially answers questions concerning the "adequacy of existing arrangements to provide consumer credit at reasonable rates."

In a related area, the Commission has contracted to analyze the debt position of families in poverty areas. This study is intended to help ascertain whether poverty neighborhood consumers whose income, stability of income, and the liquid assets resemble nonpoverty area residents can get credit as readily in the same amounts as their nonpoverty area counterparts. It will also explore the possibility of variances

in the availability of credit as between racial groups in the poverty and nonpoverty areas.

The Commission has initiated a pilot study to determine what happens to applicants rejected for retail credit by large retailers. This study should provide some indication of the extent to which the consumer's basic need for retail credit was genuine in the sense that his drive for purchase was strong enough to motivate him to search for other sources of credit. The study should also disclose what other sources of credit were approached and the socio-economic characteristics of consumers denied credit by other such retailers.

The Commission is currently attempting to compile and evaluate experimental credit granting programs now in operation in the United States. Sources of credit for these programs include low income credit unions, banks and retail merchants. The Commission is also compiling and evaluating credit counseling and educational programs.

The Commission has queried all state and local bar groups as to their views and activities regarding various debt collection practices. Responses are currently being examined.

Other projects in preliminary stages are:

A study of the cost structure of consumer finance companies and the retail industry.

A study of how low rate ceilings on credit affect the price of retail goods.

A theoretical study of imperfections and competition in consumer credit markets.

A history of rate making and regulation.